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Savings Mobilization Strategies:
Lessons From Four Experiences

Introduction

Around the world, poor households save in various forms and for various purposes. Although empirical evidence suggests that the poor would deposit if appropriate financial institutions and savings facilities were available, little progress has been made to establish MFIs as full-fledged financial intermediaries. In fact, today most micro-finance institutions (MFIs) offer only credit, and savings mobilization remains the forgotten half of micro-finance.

The CGAP Working Group on Savings, formed in 1996 and chaired by GTZ (representing Germany), has recently completed case studies of four deposit-taking MFIs and a related comparative paper. This note represents a synopsis of these studies.

Potential for Savings Mobilization

People save to compensate for uneven income streams. Poor households save for various purposes, such as insurance against bad health, disability and other emergencies, investments, social and religious obligations and future consumption. Poor households save in-cash, in-kind (animals, gold, grain, land, raw material and the like), and use rotating savings and credit associations and other forms of financial and non-financial savings and loan associations because of limited access to appropriate deposit facilities.

Evidence shows that the poor will hold financial savings in savings accounts with financial institutions, if appropriate savings facilities are available. The following factors influence the household's decision to hold a savings account:

- *Security of savings and confidence and trust in the repository of the savings*, in other words, "the trust factor."
- *The liquidity of the savings option*. Quick access to deposits is especially crucial for poor households for emergencies and investment opportunities that emerge suddenly.
- *The transaction costs, e.g, the cost of making a deposit and of liquidating it*. Time spent traveling to the financial institution, waiting in line, and on paperwork can represent such high costs that a seemingly positive real rate of return becomes negative and small savers will rather turn to informal means of savings.
- *The real interestrate*. Although there is evidence that rural savings takes place even under negative real returns offered by the informal sector, evidence from different countries has shown that the demand for savings products by all savers, including the poor, increases as interest rates increase.

The Benefits of Savings Mobilization for MFIs

Savings mobilization can help MFIs to expand and deepen their outreach. A larger number of poor households may use savings services than credit services. In particular, poorest households may rely on savings before they have an effective demand for credit. Moreover, deposits from the public are a less volatile source of funds than alternative sources, such as rediscount lines from the Central Bank or funds from donor agencies. This stable funding source can expand lending operations and, hence, also benefit poor borrowers.

Mobilizing small and micro-savings can contribute to self-sustainability by providing the MFI with cheaper funds than those from the interbank market. However, there may be a trade-off between the lower financial costs and the relatively high costs of mobilizing and administering small deposits.

Attracting depositors may instill a stronger demand-orientation and thriftiness in MFIs' operations and increase public confidence. As savers become important stakeholders in deposit-taking institutions, the latter are forced to improve their product variety and efficiency of services. Moreover, **effective** prudential regulation and supervision can increase the public's confidence in an MFI's financial operations.

The Challenges of Savings Mobilization by MFIs

A hostile macroeconomic and financial sector environment. Even the most efficient MFIs find it difficult to attract savings from poor clients when political turmoil and high annual inflation rates prevail. When there is uncertainty about the future, people prefer non-financial assets as hedges against instability. Also, MFIs find mobilizing savings a loss-making venture when extensive government interference exists through interest rate controls and subsidized credit.

Absence of regulatory framework tailored to the special characteristics of MFIs. In the absence of specific prudential regulation for micro-finance, most MFIs would have to transform into formal financial institutions. To become a formal institution, however, MFIs have to meet high minimum capital requirements, abundant requirements for loan documentation and collateral that most cannot fulfill. In addition, these legal stipulations are not adjusted to the specific risk exposure of MFIs, such as high turnover of loans due to short maturities or use of collateral substitutes.

More sophisticated management capabilities. While some MFIs have experience screening clients and monitoring loan repayment to minimize the probability of default, risk management requirements for deposit-taking institutions to protect poor depositors are more stringent and complex. Deposit-taking MFIs will need to train and motivate their staff to meet the challenge of matching assets and liabilities (matching the different maturities and sizes of small credit and savings accounts) to manage liquidity appropriately. The interest rate spread (the difference between the cost of mobilizing savings and the earning on loans) will have to be carefully managed to ensure institutional sustainability. Cost accounting and control of expenses can inhibit the introduction of small and micro-savings facilities because in the short to medium term it may become a cost-intensive endeavor.

Case Studies of Savings Mobilization Strategies

GTZ carried out case studies of four banks: the Bank for Agriculture and Agricultural Cooperatives in Thailand (BAAC), the Banco Caja Social in Colombia (BCS), the Bank Rakyat Indonesia (BRI) and the Rural Bank of Panabo in the Philippines (RBP). These institutions were selected because (i) the average amount on deposit is far below the average GNP per capita,

(ii) the number of savers exceeds the number of borrowers, (iii) the actual number of savers represents a large share of the potential market, and (iv) savings are the most important funding source, contributing more than 50 percent to total liabilities.

BAAC and BRI are government-owned banks, BCS is owned by the Catholic Church in Colombia, and RBP by private investors. While the BAAC exclusively provides financial services to agricultural producers and their respective organizations for agricultural production, clients of the other institutions are comprised of low-income and middle-income household-enterprises from all sectors. BCS is the only bank of the sample that exclusively operates in urban areas.

Outreach and Performance Indicators, 1996[a]

Performance Indicators	**BAAC** Thailand	**BCS** Colombia	**BRI-Unit Desa** Indonesia	**RBP** Philippines
Ownership	Government	Private	Government	Private
GNP per capita	3,000	2,000	1,070	1,190
Lending activities				
Volume of loans outstanding	5,590 million	513 million	1,713 million	5.6 million
Number of loans outstanding	2.4 million	209,000	2.5 million	6,350
Average loan size	2,329	2,455	685	882
Avg. loan as proportion of GNP	77%	123%	64%	74%
Savings activities[b]				
Volume of deposits outstanding	1,875 million[c]	279 million	2,600 million	2.7 million
Number of deposit accounts	4.2 million[c]	1.1 million	16 million	10,850
Average deposit size	447	254	163	249
Avg. deposit as proportion of GNP	15%	13%	15%	21%
Financial intermediation indicators				
Deposits to loan ratio	71%	101%	181%	80%
Deposits to liabilities ratio	65%	87%	89%	72%
Profitability indicators				
Return on assets [d]	0.35%	2.5%	5.5%	7.0%
Return on equity[e]	2.82%	19.0%	not available	36.7%

[a] All amounts epxressed in US Dollars
[b] Demand deposits only (does not include time deposits)
[c] For end of 1995
[d] Net income or profits before taxes/average total assets
[e] Net income or profits before taxes/average total capital

All four institutions show impressive outreach. They serve between 10 percent (BCS) to 85 percent (BAAC) of the households that compose the potential market for these institutions. The number of savers exceeds borrowers by two to eight times.

The average loan amount (a proxy for determining the ability to reach low-income households with credit) is generally below, and in the case of BCS only slightly above, GNP per capita in the respective countries. The average savings accounts represent less than one-fifth of GNP per capita of each country, suggesting that the institutions reach very poor households with their savings services. Deposits represent between 65 percent to over 80 percent of total liabilities in the four institutions. Financial indicators for all four show high rates of return (ROA, ROE) and high operational efficiency.

Factors for Successful Mobilization of Small and Micro-savings
A comparison of the banks' experiences points to seven key factors that contributed to the success of small and micro-savings mobilization.

Economic Reform and Financial Sector Liberalization. In each case, liberalization resulted in increased competition for the MFIs, which made them broaden the array of financial products offered, particularly savings, and incorporate new groups of customers, particularly the poor. For public banks like BRI, government support without interference in day-to-day operations made financial intermediation a profitable undertaking. Elimination of cheap financing available from government institutions stimulated the interest of BAAC and BRI to mobilize savings. And finally, relaxation of interest rate controls enabled all four MFIs to set interest spreads on a profitable basis.

Institutional Type and Governance. Governance, ownership, and reputation of the institution are crucial in attracting savings because they lend to (or detract from) depositor confidence about the safety of their savings. Savings customers are comfortable about entrusting their savings with the four institutions as their owners are well-known, and are perceived as trustworthy and risk-conscious. For example, BCS in Colombia is part of one of the largest and most well-known holding companies owned by the Catholic Church in Colombia. Most depositors are confident that their savings will be safeguarded if BCS suffers a severe solvency crisis.

Because governments tend to rescue troubled public banks, government-owned banks such as BAAC and BRI have some advantage in savings mobilization over privately-owned institutions in the absence of an effective deposit insurance system. The implicit guarantee raises customers' confidence in the deposit facilities of these institutions. This guarantee may provide a cost advantage over private financial institutions, because the latter often must compensate for the lack of an effective deposit insurance system by paying higher interest rates to attract deposits.

The vulnerability to government intervention, however, is omnipresent in publicly-owned institutions. BAAC and BRI continue to implement mandated government credit programs with poor results. The losses from these operations are either covered by government funds in the case of BAAC or absorbed by the profits generated by the unit desas in BRI. These transfers represent a loss of resources and inhibit profitability in both cases.

The governing bodies (or boards) of BCS, BRI, and RBP have played a critical role in the MFIs' successful savings mobilization strategy in two ways. First, they defined savings as a key element of corporate identity and made it an integral part of the institution's services. Second, they implemented sufficient checks and balances, including getting involved in strategic business planning and decision-making to ensure sound financial performance and preserve customer confidence.

Organizational Structure. The closer the MFI gets to its customers, the larger the number of small depositors with access to savings facilities. BAAC, BCS and BRI have extensive branch and field units located strategically where poor people live or work (e.g. market places). The latter is also true for RBP although it does not operate on a nation-wide scale. These field units--particularly those of BAAC and BRI--are generally lean, low-cost operations, with only essential staffing and facilities. The units/branches are treated as cost centers with incentives for efficient operations. Decision-making is decentralized (with adequate oversight) and structured to foster transparency and accountability.

Field offices of BCS, BAAC, and BRI have access to an internal liquidity pool and support services for other functions, such as training and new product development. Such access to secondary structures allows the institutions to benefit from economies of scale.

Savings Products and Technologies. Individual, voluntary, and open-access savings accounts have proved most successful in attracting savers. Though BAAC, BCS, and RBP have been experimenting with compulsory, locked-in savings or group accounts, these services have produced lower outreach and a remarkably slower growth of the deposit base than voluntary deposits. In the experience of these institutions, compulsory savings as a requirement for loans were perceived as a cost to borrowing rather than a service by itself.

When an MFI shifts to voluntary savings mobilization after a long history of forced savings, it can face a number of challenges. For example, despite the change in policy at BCS, in practice, its staff continues to require savings from customers who want access to credit. The bank is also burdened with administering a considerable number of 'dormant' savings accounts with very low balances from customers who did not close accounts after repaying loans.

Small minimum balance requirements by all four of the MFIs lowered the barriers to savings facilities for poor households. Savers can open an account with a minimum deposit of US$2 at BAAC, US$3.80 at RBP, US$4 at BRI, and US$50 at BCS.

Rapid access to deposits is also appealing to poor households. All four banks offer at least one liquid savings product with unlimited withdrawals. In addition, they offer semi-liquid savings accounts and time deposits with a fixed term to address the needs of various market segments. To offset the higher costs associated with managing small savings accounts, the MFIs paid no interest on balances below a specified minimum. And as a financial incentive for savers to increase deposits and avoid making withdrawals, interest rates paid increased with the account balance.

Lotteries appear effective in attracting savings from poor households. In BRI, savers with a stipulated minimum deposit participate in a drawing to win prizes, such as motorcycles and jeeps. The lottery drawings are important social events in the community and provide opportunities to promote new or existing financial products. They strengthen the customer-bank relationship that is crucial for depositors' trust in banking operations.

Simple design of savings products makes it easier for savers to select the product that best suits their needs, and for the MFI's staff to administer them. BRI's savings services are notably easy to understand and possibly a major factor in garnering 16 million small saving accounts. Similarly, eye-catching trademarks for savings products (BAAC, BCS and BRI) can also help savers better understand the particular design of each savings products and to distinguish them from those of competitors. Market studies and pilot-testing of new savings products are of utmost importance. BCS and BAAC have special divisions at headquarters level for the design and improvement of savings products.

Risk and Liquidity Management. All four institutions manage risk through strict borrower screening, diversifying the loan portfolio, monitoring borrowers, and following sound provision policies.

For prudential liquidity management, each of the MFIs has established an internal liquidity pool or is linked to the liquidity pool of a partner organization (another bank). The internal liquidity transfer price is set high enough to encourage savings mobilization. Empirical evidence from BRI and BCS shows that an internal liquidity price close to the interbank lending rate is conducive for savings mobilization.

Regulatory Framework and Internal Control. Prudential regulation and effective supervision provide guidelines for sound financial management practices and thereby safeguard the interest of depositors. Each of the four countries reformed their financial sector regulatory frameworks during the 1980s and 1990s. The new regulations specified capitalization levels based on level of risk of assets and set minimum standards for management capabilities and financial performance.

Despite the restructuring of the financial sector, external supervisory capacity in the Philippines and Indonesia has been weak. Liberalization of the financial sectors in these countries has led to a mushrooming of new financial institutions and taxed the capacity of the supervisory bodies. While prudential norms for micro-finance are still emerging, a proven track record of the ability to operate as sound financial intermediaries will remain critical to the successful mobilization of savings.

In the absence of effective supervision and the lack of a reliable deposit insurance system, internal auditing often takes on a more important role than external supervision. In BAAC and BRI, headquarters monitor regional offices, regional offices supervise the branches, which in turn control banking operations in the field units.

Lowering the Cost of Savings Mobilization. The four MFIs lowered administrative costs through designing simple savings products, offering differentiated interest rate systems with no interest on low balance accounts, and maintaining lean field offices with the same staff handling lending and savings services. In addition, each institution has adequate built-in mechanisms such as a performance bonus system to instill high levels of operational efficiency and encourage savings mobilization. They also have access to an internal or external liquidity pool that reduces cash-holding and the proportion of non-earning assets to keep operating costs low.

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This note is a synopsis of the following five papers published by Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ - German Technical Cooperation) with funding from the Federal Ministry for Economic Cooperation and Development (BMZ) in Germany. Thesynopsis was prepared by Joyita Mukherjee of the CGAP Secretariat and Sylvia Wisniwski of GTZ.

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Copies of these papers are available from:

GTZ
Financial Systems Development and Banking Services
Attn. Alfred Hannig
P.O. Box 51 80
D-65726 Eschborn, GERMANY
Phone: 49-6196-79-1375
Fax:49-6196-79-6150
E-mail: alfred.hannig@gtz.de